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Comment on Marchesi and Sitori (2011): Why is two better than one? Some comments on cooperation and competition between the World Bank and the IMF

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1 Introduction

In their paper "Is two better than one? The effects of IMF and World Bank interaction on growth" Silvia Marchesi and Emanuela Sitori (2011, in this volume) find that overall outcomes are improved if both organizations simultaneously support a given country. They interpret these results as the effect of cooperation.

Surprisingly, the interaction between the two International Financial Institutions (IFIs) has not been systematically analyzed before in an econometric study. However, in recent years, starting with Knack and Rahman (2007), a considerable literature has developed on donor cooperation (or the lack of it) more generally.

However, in the context of this literature, the perspective on cooperation is quite different. Simultaneous financing of a given country by a multitude of donors would never be regarded as a sign of cooperation. Rather, these are the cases in which this literature would suspect a cooperation *problem* to come up. In fact, studying whether donors actually cooperate is perceived as relevant only in situations where donors are active simultaneously in the first place.

In the following, I will be looking at Marchesi and Sitori's (2011) results from this perspective. I will start by a theoretical reexamination of what may potentially drive their results (Section 2). To distinguish between those arguments that appear plausible in the first place, I will then draw from the literature and from own case-

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study experience (Section 3). I thereby try to provide some initial insights along the lines suggested by Marchesi and Sitori for further research—to open the black box of IFI cooperation using some concrete examples from the field. Eventually, this will lead us to reconsider whether we can really expect cooperation to drive their results.

2 Some Theoretical Considerations

To understand Marchesi and Sitori's (2011) econometric finding that simultaneous World Bank-IMF activities in a given country lead to better outcomes than the sum of each institution's individual activities, let us first consider a set of alternative arguments:

(1) When the two institutions are active in the same country, they *effectively cooperate*, e.g., by exchanging information, by common conditionalities and by joint monitoring. In the donor-recipient relationship this would come close to having one principal rather than two—thereby enhancing the recipient's incentives to effectively comply with the principal's objective. This should improve accountability and thus outcomes (provided the IMF and the World Bank themselves provide useful policy advice). However, this reasoning only holds against a baseline situation in which both organizations work in a given country simultaneously without cooperation. It is not clear why the cooperative situation should be preferable to a situation in which one institution carries out all activities on its own. Therefore, this argument cannot explain the finding by Marchesi and Sitori.

(2) As mentioned by Marchesi and Sitori, there could also be *complementarities* leading to improved outcomes even as compared to a situation where only one institution is active in the country. These complementarities may arise through a useful match of IMF and World Bank activities. This is not necessarily a matter of particular cooperation efforts, but it may be. In any case, this could explain why joint presence in a country would lead to systematically improved economic outcomes.

(3) There could be a simple effect of *joint financing* lifting aid over a certain threshold above which it becomes more effective. Or, more generally, there could be increasing returns to aid. This explanation would have nothing to do with cooperation. However, the aid effectiveness literature has so far shown evidence of decreasing rather than increasing returns (Hansen and Tarp 2001). Moreover, we should then find a stronger effect not only when both institutions have programs running, but also when one institution has two programs (or a bigger program) running. Therefore, this argument cannot explain the finding by Marchesi and Sitori.

(4) The reason for a positive effect of both IFIs being simultaneously present in a country may also be their *competition*, rather than their cooperation. In his comprehensive, case study based analysis of Bank-Fund cooperation Fabricius (2007) argues that certain frictions between the IMF and the World Bank may allow ministerial officials in the borrowing countries to better understand the issues at stake, to take their own decision by playing the two institutions out

against each other, and to reach a situation with stronger local ownership of the final policy agreement. In particular if—as opposed to the assumption made under (1)—we acknowledge that neither the IMF nor the Bank are immune to errors in their policy advice (or the corresponding conditions prescribed), it may be helpful if their position is not adopted without critical reflection (Fabricius 2007: 48 ff.).

(5) Finally, results may simply not reflect realities, but problems with the *econometric specification*. In particular, there may be remaining endogeneities, first, due to the necessity to rely on instrumental variables that are not always fully convincing (shouldn't economic variables like the debt stock have a direct effect on growth, independently of World Bank or IMF activities?), or second, due to specific conceptual qualities of more recent lending instruments such as Poverty Reduction Strategy Paper (PRSP) related lending in which IMF and World Bank jointly act by design.

I will not consider the 5th argument here since it is almost impossible to construct any econometric model without some remaining concerns in this area, and dwelling on this debate will not advance us much over here. If we also discard the 3rd alternative for lack of coherence with the existing literature, and the 1st alternative, for lack of internal consistency, we are back to arguments 2 or 4, i.e., either complementarities or competition.

At this point, it seems to be useful to provide some concrete evidence to see whether this theoretical reasoning is in line with practical experience, and if so, which of the remaining alternatives appears more plausible to explain Marchesi and Sitori's econometric results.

3 World Bank-IMF Interaction

Fabricius (1999, 2007) provides a large account of coordination problems. Agreements on cooperation between the two IFIs were made as early as in 1966, reinforced in 1989 and, more recently, in 1998. However, in a way, each of these new agreements simply reflects recognition of the failure of the previous ones. As the intention to cooperate was not reflected in concrete administrative procedures and incentives, it depended primarily on the chemistry between the staff in the Bank's and the IMF's respective country teams (Fabricius 2007: 24 f.). While the evidence collected by Fabricius covers primarily the time before the turn of the millennium, it is easy to collect anecdotal evidence of similar problems for the time after the 1998 agreement.

A World Bank consultant active in Latin America illustrates the issue at the example of a policy based IBRD loan extended to Peru in the mid-2000s. The Bank had conditioned its loan to the implementation of a comprehensive financial management system. Simultaneously, the country was under an IMF standby arrangement. When the World Bank loan came in, the IMF did not agree with the characteristics of the financial management system. Eventually, the IBRD had to rewrite the loan.[1]

Based on his more systematic analysis, for middle-income countries, Fabricius (2007: 36ff.) also does not expect the nature of the problem to be significantly changed through the 1998 reform. Just as Marchesi and Sitori he notes, however,

[1] Experiences reported by Christopher Humphrey, consultant with the World Bank since 2001.

that for low-income countries, the joint preparation of the PRSP agreed in 1999 for the first time provides a concrete institutionalized cooperation mechanism. Both institutions are supposed to support the government in the development of this strategy paper, whereby the Fund should concentrate on the general macroeconomic framework, while the Bank should focus on sector policies. Both institutions have to endorse the final draft, which then provides the basis for all interventions.

While the evidence collected and reviewed by Fabricius (2007) does not reach into this period, I will draw from the experience during two of my own country studies to illustrate the recent developments. I thereby primarily focus on the education sector, which is usually one of the key sectors covered by the PRSPs, and in which the World Bank typically plays a very important role.

In recent years, I had the opportunity to run two rounds of extensive interviews with donor and government officials active in basic education in two different African countries. The first was in the context of a study on basket financing in primary education in Malawi (cf. Michaelowa and Wechtler 2006), the second was in the context of a study of donors' in-country division of labor in Burkina Faso (cf. Dreher and Michaelowa 2010).

In both countries, both the IMF and the Bank were active during the period of analysis. In both countries, the institutions stuck to the roles attributed to them, the IMF being concerned merely with macroeconomic issues and not involved in any way in sector discussions. Thus, in line with the new agreements, and despite the joint involvement of both organizations in poverty reduction activities (that some people might interpret as a mission drift of the IMF towards the area of activity of the Bank), the traditional division of labor was strictly observed.

While this may be interpreted as a result of successful cooperation, a closer look at the situation sometimes reveals the opposite. The problem is that sector policies and macroeconomic policies cannot be dealt with in full separation. Education sector policies involve questions related to funding, to the size and the salaries of the civil service, to consistent financial management and budgeting issues. This is where total absence of consultation with the IMF, who separately places his conditionalities, can generate serious problems.

And indeed, the IMF is usually absent from the general donor coordination processes. The Burkina Faso case study dealt with a number of sectors and in no case, the IMF was even mentioned as a potentially relevant agency to exchange information with. The general statistics on aid fragmentation provided by the OECD/DAC did not include the IMF, either. The IMF seems to lead a life apart.

The Malawi case study provides an example of the problems this can imply. In this country, the IMF policy was effectively in contradiction with the Bank's and other donors' mid-term funding intentions in the education sector. However, there had been no discussions about this, and the problem had even gone unnoticed until our interviews shed some light on the existing inconsistencies. The IMF had set a ceiling to government expenditure and had broken this down to ceilings for individual sector budgets. Now other donors were considering bringing their funding into the government budget through joint education sector support. The idea was to enhance local ownership, to increase transparency over available funds, and to allow the education ministry to generate a reliable mid-term financial planning. However, by channeling the donor funds through the government budget the IMF ceiling would have been exceeded. This would have led to aid fungibility by construction: Further aid to education would have automatically reduced the government's own resources spent in the sector. No matter how much aid would have been contributed to the education sector budget, the education sector budget would not have increased since it had already reached the limit set by the IMF.

Discussions with an education sector consultant for the World Bank and other international organizations confirm that the pattern observed in Burkina Faso and Malawi is not unusual. He states that of about 50 international meetings of donors and government officials in a number of African and other developing countries he witnessed in recent years, not in any single case an IMF official had even been solicited for his participation. The IMF does not interfere in this area of World Bank activities. However, at times, problems with IMF budget limits inconsistent with education sector plans approved by the Bank and other donors were brought up, usually by officials from the local finance ministries.

It seems that whether such inconsistencies are detected and eventually solved depends to a large extent on the capacity of local government staff since ex ante planning processes between the IMF on the one hand, and the Bank and other donors on the other hand, appear to be largely absent.[2]

At the same time, Fabricius (2007) shows that inconsistencies between the World Bank and the IMF sometimes also lead to improved policy results. He mentions the case of Vietnam in the mid-1990s, where the government explicitly asked the Bank to provide a separate analysis of the interest rate policy, and compared it to the one pushed by the IMF. This eventually allowed the government to make its own, more informed choices on the basis of the debates between the two institutions. The competition of the two institutions had allowed the government to play a much more important role in the decision making process, and to assume ownership.

In sum, there is not much evidence of actual cooperation between the Bank and the Fund. This can lead to considerable disputes about conflicting conditionalities and policy advice. Even in the poorest developing countries, for which special institutional cooperation agreements exist in the context of PRSP related lending, at times, the lack of coordination leads to inconsistencies. Inconsistencies seem to arise, in particular, between the budget constraints imposed by the IMF and the activities approved, planned and (partially) financed by the World Bank and other donors. However, in certain situations, competition between the two IFIs can also improve development outcomes. Such situations are more plausible in middle-income countries with a certain level of administrative and economic capacity. And of course, they require a development oriented government.

4 Conclusion

The available evidence shows that there have been very frequent problems of cooperation whenever the Fund and the Bank were active in the same countries.

[2] Experiences reported by Alain-Patrick Nkengne Nkengne who worked as a staff member of the secretariat of the Conference of Francophone Education Ministries (CONFEMEN) from 2003–2005, and since then as a short-term consultant for the World Bank, Pôle de Dakar, and UNESCO (among others).

From the turn of the century onwards, new agreements between both organizations may have led to a clear division of labor in low-income countries despite joint activities related to poverty reduction. Yet, this division of labor does not eliminate the need for in-country cooperation, which often does not actually take place. In countries in which the Fund is not active, the Bank can take the lead on macroeconomic issues (as well as on sectoral issues) so that inconsistencies in policy advice and conditionality can be avoided.

All in all, there is thus little reason to believe that cooperation between the two organizations drives the positive results for simultaneous Fund-Bank activities. The successful exploration of complementarities does not appear overly plausible against the backdrop of the evidence presented above. The only argument that is not contradicted by the literature, by theoretical reasoning, or by the evidence presented, is not based on cooperation at all. To the contrary, it is based on competition between the two organizations.

While clearly, such competition is not always healthy, there are certain cases where it is. Development oriented and economically well-versed governments can make positive use of the additional freedom in a situation in which they do not face an IFI monopoly. This argument is consistent with the econometric result presented by Marchesi and Sitori (2011). It seems that competition between the Bank and the Fund has been a frequent phenomenon during the whole period and cases in which this competition was healthy may have (statistically) outweighed cases in which it was not.

This shows that interpreting the effect of simultaneous activities as an effect of cooperation can be highly misleading. If we believe the above results, what is interpreted as "cooperation" by Marchesi and Sitori, would effectively mean "competition."

If we do not believe these results, we need to either search for further arguments not covered here so far, or to end up questioning the econometrics after all.

Whatever the reader's conclusion may be, it remains that the econometric finding of a positive effect of simultaneous intervention by the Bank and by the Fund is in itself a very interesting and thought provoking result.

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